ITASCA BANK & TRUST

ECONOMIC OUTLOOK AND INVESTMENT POLICY

Q2 2018

ECONOMIC FACTORS	CURRENT OUTLOOK
U.S. GDP Growth	Following the passage of the GOP-led tax bill, Fed officials raised their median forecast for U.S. GDP growth in 2018 from 2.1% to 2.5%.
Federal Funds Rate	The FOMC hiked the federal funds rate to 1.75% in March and indicated it expects a "slightly steeper" path of rate hikes over "the next few years."
Inflation	Broad consumer inflation rose to 2.4% in March; the U.S. 10-year Treasury inflation breakeven rate climbed to a four-year high of 2.14% in mid-March.
Employment	Monthly payroll additions might be smaller in 2018 than in recent years given the 17-year low 4.1% unemployment rate.
Consumer Confidence	Consumer optimism could remain elevated in 2018 given the healthy job market and lower personal income tax rates for most Americans.
Oil	OPEC and Russia's production cut extension until the end of 2018 and uncertainty around the Iran nuclear deal could support crude oil prices.
Housing	Sales of previously owned U.S. homes hit an 11-year high in November, but higher prices and shallow inventory could weaken housing demand in 2018.
International Economies	The euro zone, Japan and key emerging market nations continue to exhibit above-trend economic growth and strong corporate profits.

	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
FIXED INCOME	●				
Core Bonds				●	
TIPS				●	
Non-Investment Grade		●			
International	●				

CURRENT OUTLOOK

We expect the U.S. Federal Reserve to continue with two or three additional rate hikes in 2018 and the global economy to maintain its broad-based expansion. This suggests to us that the path of least resistance for global bond yields in 2018 could be higher. As such, we believe a significant underweight to the broad fixed income asset class relative to our strategic target allocations is justified. Outside of our core, investment grade allocation, we believe exposure to TIPS and floating rate bonds could serve as an effective hedge against inflation and higher short-term market interest rates in 2018.

Benchmark: BB BC Intermediate Government/Credit Index

	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
EQUITIES				●	
Large Cap			●		
Mid Cap			●		
Small Cap		●			
Developed International				●	
Emerging Markets		●			

CURRENT OUTLOOK

We believe an overweight to equities relative to our strategic allocation remains appropriate. After the volatility of February and March, forward twelve-month valuations of many global equity indexes are near or below long-term averages. The aggregate profit streams of major equity markets appear well supported given a backdrop of synchronized global economic growth and a resurgence in corporate profit growth in most major economies. We believe there is a case for developed market international equities to continue their upward trend given improving economic strength and progrowth reforms in key European economies and Japan.

Benchmark: MSCI All Country World Index (ACWI)

	UNDERWEIGHT		NEUTRAL		OVERWEIGHT
ALTERNATIVES*				●	
	CAP PRES	IWSG	BAL	GWSI	GROWTH
Global Real Estate				●	●
Global Infrastructure	●	●	●	●	●
Hedged Equity	●	●	●	●	●
Arbitrage	●	●	●		
Strategic Income		●	●	●	

CURRENT OUTLOOK

Given our expectation for pronounced periods of both equity and fixed income volatility in 2018, we believe an overweight to alternative investments is sensible. As of the end of the first quarter, it is our view that the broad equity asset class is close to fairly valued and the broad fixed income asset class is likely overvalued. As such, we have constructed diversified alternatives portfolios meant to decrease the risk profile of their respective investment objective-based, multi-asset class portfolios shown at left (CAP PRES, IWSG, BAL, GWSI, GROWTH).

Benchmark: HFRX Global Hedge Fund Index

The above underweight/neutral/overweight calls represent the MainStreet Advisors current positions relative to market weights.
*Cap Pres: Capital Preservation, IWSG: Income with some growth, Bal: Balanced, GWSI: Growth with some income